United States Court of Appeals

for the Second Circuit

APPELLEE'S BRIEF

74-2306

UNITED STATES COURT OF APPEALS

For the Second Circuit

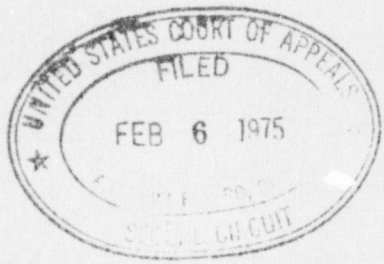
Docket No. 74-2306

IN THE MATTER

of

FAS INTERNATIONAL, INC.,

Debtor.



UNITED STATES TRUST COMPANY OF NEW YORK,
Successor Indenture Trustee-Appellant,

FAS INTERNATIONAL, INC.,
Debtor-Appellee.

On Appeal from the United States District Court
For the Southern District of New York

BRIEF OF APPELLEE

KRAUSE, HIRSCH & GROSS
Attorneys for Appellee

FAS INTERNATIONAL, INC., Debtor

41 East 42nd Street
New York, New York 10017
986-1122

Salvatore A. Adorno
John F. Scheffel
of Counsel

New York, New York
February 6, 1975

TABLE OF CONTENTS

Cases

Other Authorities

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

---x

In the Matter

of

FAS INTERNATIONAL, INC.,

Debtor.

Docket No. 74-2306

BRIEF OF APPELLEE

---x

ISSUES PRESENTED FOR REVIEW

1. Does the Bankruptcy Act (The Act) expressly authorize the Bankruptcy Court in a confirmed Chapter XI Arrangement proceeding to award as an administrative expense the expenses incurred by an indenture trustee and the fees of its counsel?

2. Does the statute as construed by the courts provide that the Bankruptcy Court has authority in a confirmed Chapter XI Arrangement proceeding to award as an administrative expense the expenses incurred by an indenture trustee and the fees of its counsel?

3. Does the Bankruptcy Court have the authority, in equity, to allow as an administrative expense in a confirmed Chapter XI Arrangement proceeding the expenses incurred by an indenture trustee and the fees of its counsel?

We submit that each of the above questions must be answered in the negative and that the opinion of the District Court, affirming the opinion of the Bankruptcy Judge (denying allowance of such reimbursement) be affirmed in all respects.

STATEMENT OF THE CASE

The preliminary statement as presented in Appellant's brief is not contested.

Further, Appellant's Statement of the Case is substantially correct, except for the following:

1. We do not agree that the language of the indenture is "ambiguous" as it pertains to subordination as Appellant states at Page 3 of its brief, and we dispute the Statement at Page 5 of the Appellant's brief that, "all sides conceded that Appellant had raised valid questions with respect to the scope and extent of the subordination...".

2. Appellant's Statement at Page 5 of its brief that the Bankruptcy Court's ruling that the indenture trustee could vote one claim on behalf of the subordinated debentureholders had the effect of "completely disenfranchising" the subordinated public debt "from any voice whatsoever in the Chapter XI proceedings" is not accurate. It is our position that that ruling had precisely the opposite effect. Because the debentureholders were subordinated to senior debt which, as was obvious throughout, never could have been satisfied in full, the subordinated debentureholders did not have a right to participate in the Chapter XI Plan of Arrangement. By designating them a separate class of unsecured debts, the Bankruptcy Judge not only gave them a voice in the proceedings but also forced the Official Creditors Committee to pay particular attention to their wishes. This is so because (as will be seen in our argument at Pages 5-6) pursuant to §362(1) of The Act no Plan of Arrangement may be confirmed without the approval of a majority in number and amount of

each class of creditors. As the representative of a separate class of unsecured creditors, the indenture trustee --- far from being disenfranchised --- held a power of veto.

3. Appellant, several times in its brief (for example at Pages 6 and 7 and at Page 18) alludes to a purported agreement whereby the indenture trustee and its counsel would be reimbursed from the debtor's estate and no one would object to the allowance. There was no agreement that Appellant should be paid from the estate as an expense of administration. There was no agreement that Appellant's application for allowances would not be objected to.

THE ARGUMENT

Point I

THE BANKRUPTCY ACT NOWHERE EXPRESSLY GRANTS ANY COURT THE AUTHORITY TO ALLOW, IN A CONFIRMED CHAPTER XI PROCEEDING, THE EXPENSES OF AN INDENTURE TRUSTEE AND FEES OF ITS COUNSEL AS AN EXPENSE OF ADMINISTRATION. APPELLANT'S APPLICATION FOR ALLOWANCES THEREFORE MUST BE DENIED.

Section 338 of The Act provides for the election of an Official Committee of Creditors to represent the interests of all unsecured creditors. (see also Rule 11-27). Section 339(1) of The Act spells out the functions of the Official Committee of Creditors and provides that it "may employ such agents, attorneys, and accountants as may be necessary...." (Bankruptcy Act Section 339(2). (see also Rule 11-29(b)). Section 339(2) of The Act provides for the payment of expenses of such a committee and the fees of its counsel:

"Expenses of the committee for such assistance... shall be allowed as an expense of administration..." (See also Rule 11-29(c) and Rule 219 incorporated therein).

The Act nowhere provides for reimbursement of expenses of any other person or body representing a creditor or creditors in Chapter XI proceedings. While Section 339(2) of The Act and the rules thereunder provide for reimbursement of expenses of agents and attorneys of the Official Creditors Committee, Appellant was not--- and it does not even allege that it was--- "employed" by or that it acted as agent or attorney of the Official Creditors Committee. Appellant is an indenture trustee and its counsel, as such it functioned solely as the representative of subordinated debentureholders. That Appellant was not "employed" by the Official Committee, a part of it, or otherwise acting on behalf of it, and that Appellant does not claim to have been such is underscored by its Statement at Page 5 of its brief that it was "disenfranchised" and excluded from the Official Creditors Committee and by its repeated claim that the subordinated debentureholders stood in a "completely adverse" position to the other creditors.

Appellant does not even contend that The Act on its face anywhere provides for compensation in Chapter XI proceedings for representatives of creditors, except the Official Creditors Committee as noted above.

It is the intent of The Act that, in the interest of economy and efficiency, a single Official Committee of Creditors should be formed to represent all unsecured creditors as Judge Gurfein points out (Page 58(a) and Page 61(a). The Act refers to a single Official Committee of Creditors.

Section 307(1) of The Act defines "creditors" to include "the holders of all unsecured debts, demands, or claims of whatever character against a debtor." (emphasis added). Section 339(1) of The Act provides that the committee consider whether the proposed Plan of Arrangement is in the best interests of "the creditors" and to negotiate with the debtor on behalf of the "creditors".

By these sections, Congress sought to assure that each unsecured creditor (and each class of unsecured creditors) shall be represented properly by the Official Creditors Committee. All creditors are invited to participate in the election of the Official Creditors Committee to the extent that they have claims that are not secured and do not enjoy priority. (Section 56(a), Rule 11-28 and Rule 207 made applicable thereby). The same section and rules provide that the Official Committee of Creditors shall be elected by a majority both in number and amount of claims. To assure that the Official Committee so elected does in fact adequately represent all unsecured creditors, however adverse they may be, Section 362(1) of The Act provides that the Plan of Arrangement itself shall be confirmed only after a majority both in number and in amount of claims in each class have approved it.

Thus, Congress sought to create a scheme that would achieve two purposes:

(a) assure that all claimants of all classes, however adverse, be adequately represented by a single Creditors's Committee in negotiating and confirming a Plan of Arrangement.

(b) to avoid burdening the estate (upon which all claimants ultimately rely) with undue, burdensome or duplicative expense. Congress provided for

one committee to represent all claimants at the equal expense of all (by charging the estate itself). It then sought to assure that that single committee would in fact safeguard the interests of all claimants by providing that (a) no Plan would be approved unless accepted by a majority in number and amount of claimants in each class (Section 362(1)) and (b) no fees or expenses of the Official Creditors Committee or its attorneys may be paid unless the Plan is confirmed (Section 339(2)).

Clearly, Congress' intent that all be represented by one committee at the expense of the estate would be frustrated if the representative of any individual creditor or class of creditors were allowed also to receive reimbursement for its expenses from the debtor's estate. To do so would prefer that creditor or class of creditors. To allow all creditors or classes reimbursement would erode the estate so severely as to, in most cases, precipitate a straight bankruptcy, thus obviating the need for Chapter XI.

Congress, in drafting the Bankruptcy Act clearly was cognizant of the valuable services indenture trustees, their counsel, and other interested parties outside the Official Creditors Committee might provide in proceedings under The Act. That this is so is obvious on the face of The Act. In writing Chapter X of the Bankruptcy Act, Congress saw fit explicitly to provide for compensation of indenture trustees (Bankruptcy Act Section 242(1) and their attorneys (Bankruptcy Act Section 242(3)), and "any other parties" (Bankruptcy Act Section 242(2).

While providing for compensation of indenture trustees and their counsel in proceedings under Chapter X of the Bankruptcy Act, Congress chose

to exclude such allowances in Chapter XI proceedings. In writing Chapter XI of the Bankruptcy Act, Congress chose the limited and explicit language of Section 339 in which is conspicuously absent any provision for reimbursement of expenses and legal fees for any creditor or representative of a creditor or a group or class of creditors other than the Official Committee of Creditors.

The explicitness of this provision is underscored by the language of Section 338 of the Bankruptcy Act which provides that the creditors may elect "a" committee. The intent of Congress clearly was to provide for streamlined proceedings in which efficiency and equal representation could be provided at the least possible expense to the estate upon which, in the last analysis, all creditors rely for any satisfaction at all.

The argument that Congress overlooked indenture trustees and their counsel in Chapter XI proceedings because Chapter XI was intended for simple reorganization and not for the adjustment of large, complex publicly held corporations, implying that Congress was not aware that large corporations go into Chapter XI too, is absurd.

Amendments to The Act precipitated by the decision in Lane v. Haytian Corporation of America, 117 F. 2d 216 (2nd Cir. 1941) (Lane) are discussed at Page 17, House Report No. 121, 90th Congress 1st Sess. (1967). From the House Report, it is clear that the amendments codify and expand Lane.

The Lane case involved a very large corporation of sufficient complexity and size that the Court itself pointed out that Chapter X would have

been appropriate. Obviously, Congress knew that large complex corporations, as well as small debtors use Chapter XI and that Chapter XI is used in cases involving indenture trustees and counsel.

Congress' exclusion of indenture trustees and their counsel from the list of parties which it expressly authorized to be reimbursed as an expense of administration in Chapter XI proceedings, rather than being inadvertent, more likely was an intentional omission. The intent may well have been to encourage indenture trustees and their counsel (who are reimbursed in Chapter X) to more readily invoke Section 328 of The Act to effect the transfer of proceedings involving complex corporate structures such as FAS out of Chapter XI and into Chapter X.

Here the indenture trustee represented subordinated creditors, the extent of whose subordination never was subjected to judicial determination and who were allowed to participate under the terms of the Plan of Arrangement due to Appellant's pressure even though they may not have been entitled to any participation at all in Chapter XI. Furthermore, Appellant never moved to convert this Chapter XI proceeding to a proceeding for a corporate reorganization under Chapter X of The Act under which Appellant's fees and expenses would be allowed.

In its discussion of the Lane case, Appellant seeks to distinguish this Court's holding in Lane from the case at bar on the ground that it is an indenture trustee and its counsel whereas Lane involved an "Independent Protection Committee" ("IPC") for bondholders. Appellant's argument is merely semantic, the "IPC's" function in a Chapter XI proceeding was

essentially the same as that of an indenture trustee : to protect the interests of public debt holders. In any case, each had the duty of representing the intersts of a specific group of creditors and neither acted on behalf of the Official Creditors Committee, neither's appointment was approved by the Court, and neither is explicitly provided for in The Act. As such, neither would be entitled to reimbursement from the debtor's estate: to allow such reimbursement would be contrary to The Act's underlying policy of paying only the Official Creditors Committee and its attorney so that the estate will not be eroded. Such is the policy of The Act as most recently enunciated by this Court in the as yet unreported case, "In the Matter of Sapphire Steamship Lines, Inc., Bankrupt-Appellant, Docket No. 74-1533, January 14, 1975, reproduced in its entirety as Appendix A of this brief (hereinafter Sapphire).

We respectfully submit that Congress knowingly included indenture trustees and their counsel among the persons entitled to expenses in Chapter X to encourage recourse to that Chapter where complex capital structures are invloved, that it knowingly excluded indenture trustees and their counsel from the persons entitled to expenses in Chapter XI, and that its intent was to limit such allowances to the persons expressly named in The Act.

Appellant argues as its third point that because Congress has shown (in enacting Chapter X of the Bankruptcy Act and Section 77 thereof) an intent to protect the interests of public debentureholders in bankruptcy proceedings, it cannot be deemed to have intended that they be left without paid representation in Chapter XI proceedings. This is a non-sequitor: to

argue that by enacting a separate chapter of the Bankruptcy Act out of concern for publicly held debt, indicates an intent to provide the same provisions in a chapter concededly not intended for proceedings involving such debt, is circular.

Congress has demonstrated repeatedly its concern for holders of public debt: The Trust Indenture Act of 1939, the Securities Act of 1933, the Securities and Exchange Act of 1934. Indeed it is concerned enough to have included Chapter X in the Bankruptcy Act,a specially tailored chapter. To write into Chapter XI, as Appellant would do, the provisions of Chapter X would make Chapter X largely redundant. Throughout the years of legislative study and amendment of Chapter XI, Congress has been well aware of the functions of indenture trustees, the Lane decision, the provisions of Chapter X, and the use of Chapter XI by corporations for which Chapter X was designed. The omission of indenture trustees from the explicit list of persons who may be reimbursed as expenses of administration in Chapter XI proceedings cannot have been so repeatedly and obvious an oversight through 37 years of legislative review and revision.

Wherefore, we submit that the Bankruptcy Judge's decision as affirmed by the District Court should be affirmed.

Point II

CASES CONSTRUING THE PROVISIONS OF CHAPTER XI OF THE BANKRUPTCY ACT HAVE NOT BROADENED ITS EXPLICIT AND LIMITED LANGUAGE REQUIRING THE ELECTION OF A SINGLE OFFICIAL CREDITORS COMMITTEE AND PROVIDING FOR COMPENSATION OF NO OTHER REPRESENTATIVE OF ANY CREDITOR OR GROUP OR CLASS OF CREDITORS. APPELLANT'S APPLICATION FOR SUCH ALLOWANCES THEREFORE SHOULD BE DENIED.

No cases are found determining the question of whether an indenture trustee and its counsel may be reimbursed as an expense of administration in Chapter XI proceedings.

Cases construing Sections 338 and 339 of the Bankruptcy Act do, however, go to the question of whether or not unofficial committees of creditors or their counsel may be awarded fees and expenses in Chapter XI proceedings. It is not disputed that the indenture trustee here represented a separate class of unsecured creditors. As such, it stands in a position closely analogous to that of an unofficial committee of creditors.

Where unofficial committees of creditors in Chapter XI have applied for reimbursement of their expenses and attorneys fees, even where the Plan of Arrangement itself provided for such compensation, their applications have been denied on the ground that such allowances are not authorized by The Act.

This Court's decisions are consistent with the rule as stated here. This Court has addressed the subject most recently in the Sapphire case, supra:

"...equity is grudgingly administered in the

award of counsel fees. See, Grace v. Ludwig, 484 F. 2d 1262 (2 Cir. 1973). This is especially true in bankruptcy proceedings where responsibility is designed to be centralized in the trustee in an effort to preserve the estate from applications for allowances by numerous importunate claimants. See, In re New York Investors, 130 F. 2d 90, 91-92 (2 Cir. 1942). As a rule, therefore, the fee of a creditor's attorney is not to be paid from the bankruptcy estate. See, Guerin v. Weil, Gotshal & Manges, 205 F. 2d 302 (2 Cir. 1953). " (Sapphire, Appendix A, Pages 5 & 6)

Sapphire involved straight bankruptcy as opposed to a Chapter XI proceeding. Just as The Act is designed to centralize responsibility in straight bankruptcy in the trustee, however, it is designed to centralize responsibility in a Chapter XI proceeding in the Official Creditors Committee. The rule that the fees and expenses of a creditor or its representative and its attorneys are not to be paid as an expense of administration also must apply to the fees of the attorney or representative of a separate class of creditors.

In only one known instance has the Bankruptcy Court allowed reimbursement of an unofficial creditors committee and its counsel. It is the unreported case, In the Matter of Fotochrome, Inc., 70 B 210, Appellant's Appendix 43-a. That decision, handed down by Bankruptcy Judge C. Albert Parente in the United States District Court for the Eastern District of New York in 1972 is not binding on this Court. It is submitted that the said decision clearly is contrary to the holding in Lane, Supra, and the other cases cited in Bankruptcy Judge Babitt's decision herein, as well as the cases cited in the decision of Judge Gurfein herein. Further, it is contrary to the rule and policy enunciated by this Court in Sapphire. As such, it plainly is in error.

In Lane, the Court noted that the proceeding involved a large corporation and the interests of bond holders represented by an unofficial committee seeking allowance. It further noted that the case more properly should have proceeded under Chapter X of The Act, adding, "But.... clearly we must treat the proceeding as legally under Chapter XI, and controlled by the provisions of that Chapter". (Lane, Supra, Page 219). The Court then denied the application for allowances of the unofficial committee:

> "That such allowances are not payable merely as expenses of administration is entirely clear from the Bankruptcy Act itself.... It is well settled that the Bankruptcy Court lacks power to grant, and the policy of The Act is against, compensation not expressly provided for by The Act." (Lane, Supra, Page 219)

Appellant's Statement at Page 11 of its brief that Lane was "specifically overruled by statute in 1952 by... amendment...." is patently incorrect. The holding was codified and expanded by the amendments referred to in Appellant's brief, not overruled. In codifying Lane and in enumerating (in Section 339 of the Bankruptcy Act) the parties employed by the Official Creditors Committee who may be paid as an expense of administration, the Legislature clearly intended to exclude all others. The amendments were intended to give strength to the Official Creditors Committee by arming it with paid attorneys and accountants to assure that it can effectively represent the interests of all creditors and all classes of creditors at limited and minimal cost to the estate by eliminating the duplication of such costs chargeable against the estate. That this is so is clear from a reading of House Report No. 121, 90th Congress, 1st. Sess. (1967).

All the references therein are to the Official Committee of Creditors and its attorneys and accountants. It is clear that the intent of Congress in amending the statute was to add bite to the policy underlying the Lane Court's holding, namely, to limit compensation to reimbursement of only the Official Committee and its agents and attorneys---thereby adding to its effectiveness and enhancing its position as the only representative of unsecured creditors in dealing with a debtor:

> "The only method of strengthening the powers of the committee is to insure that its attorneys, accountants and agents are compensated for their services." Page 17, House Report No. 121, 90th Congress, 1st Sess. (1967). (emphasis added)

It may be added that the statutory policy of compensating the Official Committee is consistent with the objective of assuring that that Committee will be representative of all unsecured creditors. It enables small creditors (who otherwise could not afford to be heard) to participate actively in the negotiations with the debtor. The policy of limiting reimbursement to only those enumerated in the Statute was stated once again by this Court on January 14, 1975, in Sapphire where the need to preserve the estate was stressed.

We respectfully submit, therefore, that the cases enunciate a policy against compensating any person not explicitly provided for on the face of The Act. We further submit that statutory amendments precipitated by the Lane case clearly endorse this policy. We respectfully submit, therefore, that the decision of the Bankruptcy Judge denying payment of expenses from the debtor's estate to the Appellants herein and affirmed by the District Court should be affirmed in all respects by this Court.

Point III

THE BANKRUPTCY COURT HAS NO AUTHORITY IN EQUITY TO ALLOW, AS AN ADMINISTRATIVE EXPENSE IN A CONFIRMED CHAPTER XI PROCEEDING, THE EXPENSES INCURRED BY AN INDENTURE TRUSTEE AND THE FEES OF ITS COUNSEL. APPELLANT'S APPLICATION FOR ALLOWANCES THERE FORE SHOULD BE DENIED.

Neither the statute itself nor cases construing applicable provisions of Chapter XI of the Bankruptcy Act authorize the allowance, as an expense of administration, of the costs and legal fees incurred by any creditors or representatives of creditors, except the Official Committee of Creditors. The only other possible source of authority for a Bankruptcy Court to allow such expenses would be equity. And it is on equity that Appellant relies.

Appellant cites Bank of Marin v. England, 385 US 99 (1966) (hereinafter Bank of Marin) at Pages 19 and 22 of its brief to demonstrate the breadth of the Bankruptcy Court's equity powers. The equity authority enunciated in Bank of Marin is not disputed. Like the Bankruptcy Act, however, the Supreme Court's opinion in Bank of Marin should not be read with the ease of a computer.

It is essential to note that in exercising its equitable power in Bank of Marin, the United States Supreme Court did not contravene that policy of the Bankruptcy Act which is aimed at preserving the bankrupt estate for the creditors. The decision did not result in added costs or in any loss to the bankrupt estate. The Court merely decided which of two parties (the bank or the payee) should be held liable to the trustee in a turnover proceeding, putting the onus on the payee as a stakeholder who ultimately was liable to

return moneys to the bankrupt estate.

The equitable consideration in Bank of Marin was that two parties need not be held liable to return the same money to the bankrupt estate---it was a matter merely of protecting an innocent middle party when, to do so, would not result in erosion of the bankrupt estate or otherwise contravene the broad policies of the Bankruptcy Act---all of which are aimed at treating all creditors equally and preserving the estate.

It is axiomatic that a Bankruptcy Court is a Court of Equity: Bank of Marin. However, it functions as such within the limits of the Bankruptcy Act and Rules:

> "The proceeding...is one in rem, equitable in nature, administered in accord with the general principles and practice of equity... though it is not a suit in equity but a statutory proceeding..." In Re Lustron Corp. (C. A. 7th 1950), 184 F (2d) 789, cert. den. 340 US 946. (emphasis added)

Collier notes that the conferring in Section 2(a) of the Bankruptcy Act upon the Bankruptcy Courts, "such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act" is intended merely to insure adequate jurisdictional coverage . (Collier 1:3.09 Fourteenth Edition, 1974, P.170).

The United States Supreme Court has written:

> "A bankruptcy court is a court of equity, §2, 11 USCA §11, and is guided by equitable doctrines and principles except insofar as they are inconsistent with the Act...". Securities & Exchange Commission v. U. S. Realty &Improvement Co. (1940) 310 US 434, 455.

Collier continues:

> "Where the Bankruptcy Act is silent, equitable principles will govern, But the equitable powers of the court are to be exercised within the limits laid down by the Act and subject to and consistent with any specific provisions contained in it." (Collier 1:2.09, 1974 Ed.) (emphasis added)

It would not be consistent with the spirit, much less the specific provisions of The Act, to allow the expenses sought here. As discussed above, The Act is specific in providing for a single committee to represent the interests of all unsecured creditors. The Act provides for the reimbursement only of that committee and its agents, attorneys and accountants. Indenture trustees and their counsel are excluded from the list of persons entitled to reimbursement for expenses and fees of counsel in Chapter XI.

To allow reimbursement of an indenture trustee and the fees of its counsel as an expense of administration in a Chapter XI proceeding would contradict The Act's explicit terms and its underlying policy. To invoke equity to do so would be to use equity where it has been proscribed by the statute as construed in the cases. Even if there were authority in equity to grant allowances not provided for in the Statute, equity would not be done to allow the expenses sought here.

"Equity" connotes equal and impartial justice between adverse parties. Appellant itself contends that the subordinated debentureholders stand in a position adverse to all other unsecured creditors. To allow Appellant the expenses it incurred in pursuing the interests of the subordinated

debentureholders' claims would be a breach of equity: to do so would be to reimburse (from the estate upon which all must rely) one class of unsecured creditors for the costs of pursuing its adverse and selfish interests. One class of claimants would, at paid cost, pursue its interests against all other claimants. The other claimants have had to rely upon an Official Committee of Creditors or pursue their claims at their own expense. Thus, to allow Appellants the costs and fees they seek as expenses of administration would be to take the subordinated debentureholders out of parity with the other unsecured creditors and afford them a preference. Indeed, having allowed the debentureholders to participate in the Plan at all (the extent of their subordination never having been judicially determined) may in itself have constituted a breach of equity by way of a preference: now counsel for the subordinated debt would compound that apparent inequity by causing the debtor's estate to pay it for having caused it.

At Page 16 of its brief, Appellant says:

> "It has never before been held in a Chapter XI proceeding that subordinated debentureholders, as general unsecured creditors, may be deprived of independent counsel where an issue arises as to whether and to what extent they are subordinated. Chapter XI treats all general unsecured creditors equally, yet without the right to such separate counsel their interests would, in reality, not be represented, certainly not 'fairly and realistically' represented".

Clearly, the issue here is not whether or not the subordinated debentureholders "may be deprived of independent counsel". The question here is who must pay for it. The debenture trustee contracted to represent

the subordinated debentureholders. The Courts below merely held that the cost of their obtaining counsel and otherwise fulfilling their obligation is not an expense of administration in a confirmed Chapter XI proceeding.

It is not disputed that the Appellants here represented one class of unsecured creditors. It is clear on the face of the record that they attempted to take control of the Official Creditors Committee without success. The Bankruptcy Court settled the ensuing controversy pursuant to Section 351 of The Act by ordering that the indenture trustee represented a separate class of unsecured creditors and that, as such, it would be allowed to vote only one claim; but that that claim would represent all $16,500,000 of the debt owed to the subordinated debentureholders.

The Court's order prevented the indenture trustee from taking over the Official Creditors Committee, whose duty it was to represent all creditors while helping the debtor come up with a plan acceptable to the majority of each class of creditors, including the debentureholders as a class. While preventing the subordinated debentureholders from taking over the Creditors Committee, the Court allowed them to participate in the proceedings. It must not be overlooked, however, that---once the Bankruptcy Judge gave them the status of a separate class---a majority of the $16,500,000 of subordinated debenture debt had to accept the Plan of Arrangement ultimately formulated with the cooperation of the Official Committee of Creditors or no Plan would have been confirmed (Section 362(1) of The Act).

That the Official Committee of Creditors effectively dealt with

the indenture trustee (as the representative of that class and in accordance with the terms of its agreement embodied in the indenture) is obvious. Appellant's contention that the official committee could not or did not adequately represent the subordinated debentureholders along with all of the other unsecured creditors is absurd. So long as the senior debt of FAS was not paid in full, there was no duty to pay the subordinated debenture-holders anything (In re Itemlab, Inc., 197 F. Supp. 134 (E. D. N. Y. 1961) (Itemlab) : they could have been excluded entirely from the Plan according to the agreement they made when they became subordinated debentureholders. They had accepted the risk of insolvency. Yet they were included in the Plan because no Plan could have been confirmed without their assent. (Section 362(1) of the Act).

Further, the indenture trustee and its predecessor, both sophisticated and experienced institutions well versed in the business, had bargained for its remuneration and expenses with full awareness of the possibility of insolvency and with sufficient resources and experience to assess the probability and effect thereof. Likewise, counsel for the debenture trustee is a presitgious and experienced law firm familiar enough with Bankruptcy Act to have (a) succeeded in having a class of subordinated creditors included in a Plan of Arrangement and (b) protected that subordinated debt from the strict priority rule that applies in Chapter X of The Act.

For the committee to have failed to represent adequately the subordinated debentureholders would have been futile. As noted, no Plan ever would have been accepted by a majority, both in number and amount,

of all classes of claimants and been confirmed. By Judge Babitt's order, the subordinated debentureholders were a class. The indenture trustee's single vote was a veto power.

Obviously, each creditor and each class of creditors stands in a position "adverse" to that of every other creditor in any proceeding under The Act. The Act is designed, however, to assure, as noted above, that the Official Committee of Creditors will transcend that adversity and represent all unsecured claimants and classes of unsecured claimants equitably. Appellant's claims of "adverse" interests and inadequate representation clearly are hollow.

To allow expenses and counsel fees for each creditor or class thereof in order that they may maximize their partisan participation in the proceedings would negate the purposes of forming an official committee and, no doubt, would have the effect of bankrupting otherwise salvable debtors. To do so, would obviate the need for Chapter XI. If this debenture trustee and its counsel are entitled to reimbursement from the Chapter XI estate, surely too are all other creditors and creditor groups and their counsel.

In its "Statement of the Case" Page 2-9 of its brief, the indenture trustee and its counsel go to great lengths to project the impression they did a great deal of valuable work to protect the subordinated debentureholders from being excluded from the proceedings or unjustly cut out of the Plan by the Official Creditors Committee. It must be remembered that the debentures were subordinated at least to the senior debt. Therefore, unless at least the senior debt was paid in full (and it was not) the debentureholders represented

by Appellant were not entitled to participate in the Plan of Arrangement at all. (In re Itemlab). Appellant was persistent and the Bankruptcy Judge allowed the subordinated debentureholders to participate as a separate class of creditors. As such, they ultimately were allowed to receive stock in the debtor corporation pursuant to the Plan of Arrangement.

Appellant's contribution to the proceedings or the debentureholders' welfare is not, however, the question. Assuming that, as Judge Babitt noted in his decision, Appellant performed valuable services for the subordinated debentureholders, the question on review here remains. It is not the question of the value of Appellant's services to the subordinated debentureholders, it is a question of whether or not the Bankruptcy Court had the power to award compensation for those services as an expense of administration in a Chapter XI proceeding.

Appellant says in essence that it should be paid as a matter of equity because it was successful in having the debentureholders included in the Plan of Arrangement and in having them receive shares of stock of the corporation. Appellant urges this argument in equity even though, as noted above, the debentureholders had no right to receive stock or any other dividend because they were subordinated to senior debt which was not paid in full. Having relentlessly fought the Official Creditors Committee, Appellant thus succeeded in eroding (by 20%) the size of the estate which the non-subordinated creditors were left to share. Appellant now would invoke equity to reward it for achieving that inequitable result.

We respectfully submit, therefore, that the Bankruptcy Court has no

equitable power to allow, as an expense of administration in confirmed Chapter XI proceedings, the expenses and legal fees of any persons not expressly provided for by The Act. We submit also that, even if the Bankruptcy Court had such equitable authority, it would be an abuse of that authority to allow the expenses sought here: to do so would prefer one class of unsecured creditors over all others in a case where they apparently had no right to share in the Plan at all.

CONCLUSION

We submit that the granting of allowances to the indenture trustee and its counsel in this Chapter XI proceeding is not authorized by the statute, the cases, or Equity.

To allow Appellant's application for such expenses would go beyond the intent of Congress as expressed in the clear and limited language of Section 339 of the Bankruptcy Act which section provides only for reimbursement of a committee elected pursuant to Section 338 of the Bankruptcy Act and such "agents, attorneys and accountants" as it may employ.

Payment of expenses to any creditor, group of creditors or exofficio representatives of any of them is beyond the scope of the authority vested in the Bankruptcy Court by Congress by the terms of the statute and as they are construed in the cases. The policy of The Act is to preserve the estate for all of the creditors.

To allow this Appellant the expenses and fees it seeks would not be equity, even if the invocation of equity were apropos where, as here, its

scope has been limited by statute.

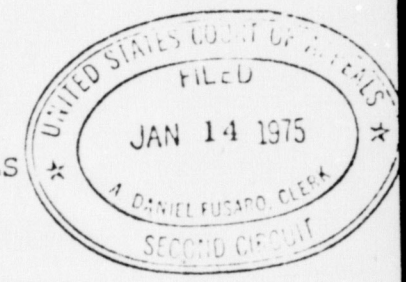
We submit, therefore, that the decision of the Bankruptcy Court, denying the allowance of such expenses and fees to Appellant as affirmed by the District Court should be affirmed by this Court in all respects.

Respectfully submitted,

KRAUSE, HIRSCH & GROSS
Attorneys for Debtor-Appellee
41 East 42nd Street
New York, N. Y. 10017
(212) 986-1122

SALVATORE A. ADORNO,
JOHN F. SCHEFFEL,
Of Counsel.

APPENDIX A



UNITED STATES COURT OF APPEALS

For the Second Circuit

No. 158 September Term, 1974

(Argued November 7, 1974 Decided January 14, 1975

Docket No. 74-1533

74-1533

In the Matter of
SAPPHIRE STEAMSHIP LINES, INC.,
Bankrupt-Appellant

and

J. READ SMITH,
Trustee-Appellant

v.

WINTHROP, STIMSON, PUTNAM & ROBERTS,
ATTORNEYS FOR E. BERGENDAHL CO., INC.
(NEW YORK) and E. BERGENDAHL CO., INC.
(PHILADELPHIA), CREDITORS,
Appellees

Before KAUFMAN, Chief Judge, ANDERSON and MULLIGAN, Circuit Judges.

Appeal by the debtor and the trustee in bankruptcy from an order of the United States District Court for the Southern District of New York, Milton Pollack, Judge, granting an application for payment from the bankruptcy estate of counsel fees to counsel for two creditors for services to the estate. Reversed.

Louis P. Rosenberg, Esq., Brooklyn, New York (Alfred A. Rosenberg, Esq., and William Steingesser, Esq., Brooklyn, New York, on the brief) for Trustee-Appellant

Terence H. Benbow, Esq, New York, N. Y. (Winthrop, Stimson, Putman & Roberts, Attorneys Pro Se, Appellees, Victor S. Trygstad, Esq., and Steven A. Berger, Esq., New York, N. Y., on the brief) for Appellees

Joseph L. Alioto, Esq., Special Counsel to the Trustee, Pro se San Francisco, California (Robert E. Sher, Esq., and Robert A. Randick on the brief).

ANDERSON, Circuit Judge:

Sapphire Steamship Lines, Inc. (Sapphire), prior to its adjudication as a bankrupt, instituted an action to recover treble damages from several of its competitors for alleged antitrust violations. After bankruptcy intervened, the trustee, J. Read Smith, was substituted as plaintiff and was duly authorized by court order to retain Joseph L. Alioto as special counsel to prosecute the action.

Negotiations between the special counsel and counsel for the antitrust defendants resulted in a settlement offer of $1,600,000 in July, 1970. It was the position of the special counsel that, although plaintiff had a strong case on the question of liability, there was insufficient evidence on the issue of damages to warrant further negotiations. Based upon the recommendation of the special counsel that the §1,600,000 was "fair and reasonable", the bankruptcy court issued an order authorizing the trustee to accept that amount in settlement of the suit.

Several creditors of the bankrupt, including the United States and two corporate creditors represented by Winthrop, Stimson, Putnam & Roberts (Winthrop, Stimson), opposed this settlement and jointly moved for a reconsideration of the order, supporting their motion with legal memoranda relating to the issue of damages.

The bankruptcy court granted the motion for reconsideration, and "[p]rimarily because/[of] evidence produced . . . by the Government" at the hearing, vacated the original order and withdrew its approval of the settlement offer.[1.]

At various times during the renewed settlement negotiations, counsel for the antitrust defendants requested conferences with the Assistant United States Attorney who was representing the Government's interest as a creditor in the bankruptcy proceeding. Defendants argued that the priority claims of the United States would be substantially met if the particular offer then under discussion were approved and for that reason, they urged the Government to withdraw its opposition. Lawyers from Winthrop, Stimson also attended these conferences and participated in the discussions at the request of the Assistant United States Attorney.

When the settlement offer was increased from $1,600,000 to $2,000,000, Mr. Alioto again recommended acceptance but the Government and Winthrop, Stimson were still opposed and the bankruptcy court, therefore, never approved of the new offer.

Finally, after continued two-way negotiations--between defendants and special counsel, and between defendants and the Assistant United States Attorney, who requested and received assistance from Winthrop, Stimson--a settlement offer was made in the amount of $2,473,070. The Government recommended acceptance of this offer and the settlement was formally approved by the bankruptcy court, although Winthrop, Stimson opposed this offer also.

Thereafter Winthrop, Stimson filed claims for its services with the bankruptcy court in the amount of $175,000, plus disbursements.[2.] It claimed that, by reason of its efforts, a better settlement was obtained and the estate was substantially augmented to the benefit of all creditors. None of the creditors opposed this fee application and several affirmatively endorsed it.

The bankruptcy court, however, rejected Winthrop, Stimson's application on two grounds: (1) Winthrop, Stimson could not take full credit for the reconsideration and subsequent disallowance of the first settlement; and (2) at no time did it act as counsel to the trustee, but argued solely for its own clients, to whom it was required to look for payment.

The United States District Court on petition for review of the decision of the bankruptcy court, remanded the claims with instructions to compensate Winthrop, Stimson for the fair and reasonable value of its services.[3.] The district court found that while Winthrop, Stimson may not have been solely responsible

for the setting aside of the first settlement order, it had made a contribution toward that result and also to the $800,000 increase in the bankruptcy estate.

The trustee and Sapphire appeal from the district court's order granting Winthrop, Stimson counsel fees from the bankruptcy estate.[4.] They argue on this appeal that the finding that Winthrop, Stimson's services contributed to the enhancement of the estate in a specified amount is clearly erroneous. Although it is true, as they point out, that the fund was created by the third offer of $2,473,070 which Winthrop, Stimson continued vigorously to oppose, the district court's finding that the activities of the Winthrop, Stimson firm contributed to the reconsideration and disapproval of the first two offers is supported by the record,[5.] and, because the rejections of the first two offers were prerequisites for the proposal and eventual acceptance of the final settlement, it is a reasonable inference that Winthrop, Stimson "contributed to" the creation of the additional $800,000 fund. In spite of this finding, however, the district court was in error in holding that Winthrop, Stimson was entitled to fees from the bankruptcy estate.

As a court of equity, the district court, sitting in bankruptcy, has the power to order the payment of fees from the estate to compensate counsel who, in advancing their own client's interest, have benefited all creditors. But equity is grudgingly administered in the award of

counsel fees. See, Grace v. Ludwig, 484 F.2d 1262 (2 Cir. 1973). This is especially true in bankruptcy proceedings where responsibility is designed to be centralized in the trustee in an effort to preserve the estate from applications for allowances by numerous importunate claimants. See, In re New York Investors, 130 F.2d 90, 91-92 (2 Cir. 1942). As a rule, therefore, the fee of a creditor's attorney is not to be paid from the bankruptcy estate. See, Guerin v. Weil, Gotshal & Manges, 205 F.2d 302 (2 Cir. 1953).

Winthrop, Stimson recognize this rule but argue that it is entitled to have its fee paid from the estate under an exception for situations in which (1) the trustee has refused or neglected to act and (2) the applicant has conferred a tangible benefit on all the creditors by acting in the trustee's stead.

To qualify for this exception, however, a creditor's attorney must satisfy a third requirement, i.e. the bankruptcy court must have formally authorized such attorney to act instead of the trustee. In re New York Investors, Inc., supra; In re Porto Rican American Tobacco Co., 117 F.2d 599 (2 Cir. 1941); In re Progress Lektro Shave Corporation, 117 F.2d 602 (2 Cir. 1941).

In this case Winthrop, Stimson qualifies under neither the first nor the third requirements of the exception. A trustee "refuses" or "neglects" to act when he fails to satisfy a duty imposed upon him by the Bankruptcy Act,

which requires that he marshall the assets of the bankrupt and, as with all his substantive duties, exercise reasonable care in so doing. 11 U.S.C. §75. The trustee in this case did not refuse or neglect to pursue Sapphire's antitrust cause of action, nor did the district court find that he violated his duty of care in that pursuit. Although subsequent events established that the strategic decision to recommend acceptance of the first offer of $1,600,000 was a mistake of judgment, to conclude therefrom, that the trustee "refused" or "neglected" to act would encourage creditors and their attorneys constantly to "second-guess" the trustee's decisions. Such a result would contravene the policy of preserving the estate by centralizing responsibility in the trustee.

Winthrop, Stimson concedes that it failed to secure court approval to act on behalf of the trustee, but argues that the third requirement of the exception should not apply where the trustee has not acted in the best interests of the estate. And, it asserts that its own successful opposition, to the special counsel's recommendations which the trustee was willing to accept, demonstrates that the trustee in this case defaulted in the fulfillment of his duty.

Although this court has waived prior court approval in "special circumstances," and the payment of fees was allowed to objecting counsel who had successfully opposed exhorbitant fee applications of the trustee and his counsel,

which the trustee obviously would not oppose, In re New York Investors, supra, 130 F.2d at 92, Winthrop, Stimson's services in this case were not brought about by any such "special circumstances." To waive the prior approval requirement for all cases in which counsel may successfully oppose the trustee[6] would contravene the policy of the Bankruptcy Act, and is not necessary for the protection of creditors. If Winthrop, Stimson or its clients entertained any doubt as to the trustee's sincerity in the prosecution of the antitrust suit or had lost confidence in the special counsel's competence to represent the estate, their remedy was to apply to the district court for appropriate relief--such as removal of the trustee, or disqualification of the special counsel and substitution of either Winthrop, Stimson or other counsel in the antitrust suit.

Although the district court found, in effect, that Winthrop, Stimson satisfied the second requirement in that it conferred a tangible benefit on the estate, the general rule governs this case and, despite the purported equities, Winthrop, Stimson does not qualify for the exception to the rule proscribing the payment of fees to counsel for a creditor in bankruptcy proceedings.

The order of the district court is therefore reversed.

Footnotes:

1. The Government introduced evidence at the hearing that several key witnesses were now available who theretofore were reluctant to testify or were otherwise not available. As a result the Bankruptcy Court found "proving damages was not quite as hopeless as had first appeared." The Assistant United States Attorney has deposed in the present action and stated that Winthrop, Stimson provided material assistance in locating those witnesses and in uncovering relevant documentary evidence.

2. This is 20% of $873,000, the amount by which the original offer was increased, and breaks down to an average of $100 per man-hour devoted to this matter.

3. The district court opinion is reported at 373 F. Supp. 727 (S.D. N.Y. 1974).

4. Although the evidence produced by the Government "primarily" influenced the Bankruptcy Judge to vacate his original order approving the first offer, Judge Herzog impliedly recognized that Winthrop, Stimson contributed to his decision when he stated in his memorandum opinion that "the attorney for the creditors cannot take full credit for the disapproval of the first offer."

5. The District Court had remanded the recommendation of the Bankruptcy Judge on the allowances to be paid from and by reason of the creation of the settlement fund for reconsideration and further proceedings not inconsistent with its opinion. In the Matter of Sapphire Steamship Lines, Inc., supra, 373 F. Supp. at 734. Only that aspect of the decision dealing with Winthrop, Stimson's equitable entitlement to fees has been appealed to this Court. The judgment of this Court does not affect the District Court order as it relates to reconsideration of the fees payable to Joseph L. Allegro. The Bankruptcy Judge, therefore, must now reconsider his recommendation as to the fees payable to Special Counsel and decide specifically whether he is entitled to a percentage of the entire fund or only the $1,600,000 to which he directly contributed his services.

6. Sartorious v. Bardo, 95 F. 2d 387 (2 Cir. 1938), upon which Winthrop, Stimson places great weight, does not warrant a different result. In that case it was held

"..... if a creditor successfully opposes a proposal of the trustee, it is no answer to his demand for payment to say that the trustee was in charge by hypothesis his intervention was necessary. Hence the judge would not have been justified in denying this part of the petition [even though he had not approved petitioner's actions in advance] if any substantial advantage could be traced to the services." 95 F.2d 390.

This holding was modified, however, by the subsequent decision of this Court in In re New York Investors, 130 F.2d 90, 92, from which time the rule in this Circuit has been that the prior approval requirement is waived only in cases where compensation is sought for opposing allowances to trustees and their counsel.

STATE OF NEW YORK)
COUNTY OF NEW YORK) SS:

Lileth Brown, being duly sworn, deposes and says: that deponent is not a party to the action, is over 18 years of age and resides at Queens Village, Queens, New York; that on the 6th day of February, 1975, she served the within two copies of Brief of Appellee upon the following named:

Whitman & Ransome, Esqs.
Attorneys for the United States Trust Company of New York, Appellee
522 Fifth Avenue
New York, New York 10036

Levin & Weintraub, Esqs.
Co-Counsel for the Creditors' Committee
225 Broadway
New York, New York 10007

Robert P. Herzog, Esq.
Co-Counsel for the Creditors' Committee
185 Madison Avenue
New York, New York 10016

Kelly Drye Warren Clark Carr & Ellis, Esqs.
Attorneys for Amici Curiae
350 Park Avenue
New York, New York 10022

the address designated by said attorneys for that purpose by depositing same enclosed in a postpaid properly addressed wrapper, in an official depository under the exclusive care and custody of the United States Post Office Department within the State of New York.

Lileth Brown

Sworn to before me this

6th day of February, 1975

Madeline Nelinson

MADELINE NELINSON
Notary Public, State of New York
No. 03-7350025
Qualified in Bronx County
Cert. Filed in New York County
Commission Expires March 30, 1976